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TAGS: EFIN EINV ECON TU
SUBJECT: TURKISH TEXTILE FIRMS SEE A GRIM FUTURE

REF: A. ADANA 112

¶B. ANKARA 5661

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This message has been coordinated with Embassy Ankara.

¶1. (SBU) Summary: Leading Turkish textile exporters tell us they are deeply pessimistic about prospects for the sector, warning that the end of the global quota system next month will lead to mass layoffs in Turkey unless "an exit" is found. In a recent meeting organized by the Istanbul Textile and Apparel Exporters' Union (IKTIB), representatives of more than 30 companies that currently account for close to 1 billion USD in exports to the U.S. cited not just "unfair" competition from China and India, but Qualified Industrial Zones (QIZ's) in Jordan and particularly the prospect of QIZ's in Egypt as serious threats to their future. With textiles accounting for up to a third of industrial employment in Turkey, they predicted that a "social crisis" will emerge in coming years, since there are no other sectors that can absorb the work force that will be made redundant. They pressed for reconsideration of a Turkish QIZ including textiles as their only chance for the future. Representatives of leading U.S. textile importers concurred with this gloomy prognosis, noting that change will not come immediately, but predicting that over the next few years textile exports to the U.S. will decline 20-25 percent, while (Turkey's more significant) exports to the European Union could decline by as much as half. End Summary.

¶2. (U) Represented at our recent meeting with IKTIB were such leading firms as Altinyildiz, Sahin Holding, Erteks, Tureks, Istanbul Konfeksiyon, and Mithat Giyim. While companies noted that they expect the impact of quota removal on overall Turkish export volumes to be felt over the next several years, they said that they are already feeling the squeeze on their profit margins. Many have already taken steps to reduce their work force, laying off 5 to 10 percent of their employees. Others have frozen investment plans, as they wait to see what will happen. Most predicted a further 20 percent decline in employment as the impact of the lifting of quotas is fully absorbed. Already, they said, the impact of China and India is being felt on the pricing side. They characterized the pricing pressures they face as "unbearable," and said most plants are not making any profit, but are simply operating to maintain market share. Most of the orders they receive now from the U.S. are repetition orders, which are the secondary low volume orders that supplement primary bulk orders, many of which are now sourced to China.

¶3. (SBU) Participants unanimously characterized the Far Eastern competition they face, primarily from China and India, as unfair. Chinese producers, they argued, receive formal and informal subsidies ranging from free energy, cheap bank loans -- which are essentially grants since they are rarely repaid -- and government subsidies for exports. They noted that these advantages are on top of a labor cost advantage whereby Chinese costs, at 45 USD per worker per month, are only a tenth of Turkey's 450 USD per month. In addition, companies complained that while they are frequently inspected and forced to abide by strict codes of conduct, such codes are observed more in the breach in China and India, further enhancing those countries' competitive edge. Producers noted ironically that Turkey's status as a mid-range producer has led it to be selected as a pilot country both by Western companies and countries for various pilot programs that add to their costs. They also observed that they understand that Turkey will become a test country for a new U.S. port security program, while China and India have been exempted, because the program is not "feasible" given the volumes passing through their ports. Comment: Industry representatives apparently do not realize that the Container Security Initiative, if implemented in Turkey, would actually provide them with a competitive advantage relative to producers in countries without access to a CSI

port. End Comment.

¶4. (SBU) Beyond the Far Eastern threat confronting them, producers expressed concern about competitors closer to home. They noted that QIZ's in Jordan and potentially in Egypt will take sales away from Turkey. More generally, they complained that implementation of these and other preferential arrangements, in the Americas and sub-Saharan Africa, undercut them, and they asked rhetorically why such a benefit could not be provided to Turkey, given its longstanding strategic alliance with the U.S. Already, several companies noted that they are considering moving production to Jordan to benefit from the QIZ (ironically the Istanbul-based Turkish American Business Association recently organized a briefing highlighting the advantages of such a move). They argued that only a QIZ agreement between the United States and Turkey would permit companies to maintain their existing market share in the United States.

¶5. (SBU) Producers noted that their overall woes are compounded by the strengthening Turkish lira and depreciating dollar. Companies specializing in shipping to the U.S. are especially impacted, but they conceded that the overall sector is somewhat cushioned from by the fact that the lira's appreciation against the Euro has been less marked, but even there the Chinese renminbi's link to the dollar enhances China's competitiveness there.

¶6. (SBU) Representatives of U.S. textile importers largely echoed these predictions about the impact of the elimination of quotas on Turkey. Gap's Middle Eastern Representative Gulsun Cetin (whose husband Rusen is a senior IKTIB board member), told us her company sources nearly 10 percent of its annual 6.3 billion USD in procurement from the region (and 290 million USD of that total from Turkey alone). She sees Turkish textile exports to the United States declining by 20-25 percent over the next three years. She predicts that Turkey's exports to Europe will drop even more sharply, however-- by up to 50 percent over the same period, in part because she expects the U.S. to be more aggressive than Europe in adopting safeguard measures and in part because the value of Turkey's customs union position will diminish in the post-quota environment. Cetin agreed that Turkey's disadvantage vis-a-vis the Far East stems not just from higher costs, but the difficulty purchasers have in implementing codes of conduct there. But she also criticized Turkish companies for their failure to use the last few years to upgrade their manufacturing to the next level and move to higher value added production. As a result, she said, Turkey has "no competitive edge," and optimistic predictions about Turkey's ability to compete by both politicians and industry are divorced from reality.

¶7. (SBU) As for the Gap itself, Cetin noted that she is shifting her firm's more mass market products (largely those targeted at Old Navy and Gap stores) to Egypt from Turkey. Some higher-end production, such as men's blazers, however, is moving here from Italy, given lower labor costs (18 USD per piece versus 48 in Italy). Cetin noted that Turkey can move towards these higher end items, so that overall textile export values will not decline as substantially as will volumes. But she still predicted wrenching economic dislocations, and agreed with Turkish manufacturers that it is not clear where in the economy those laid off from textile production will be able to go. Other leading export sectors, such as automotive production, are less labor intensive, and also require more skilled labor. The transition will require careful government management, our IKTIB interlocutors told us, something that has not occurred up to now.

¶8. (SBU) Comment: In contrast to their optimistic public face (a recent editorial in the Exporters' Union magazine recounting a visit to China pointed out that country's shortcomings and opined that Turks should not be overly fearful of the threat it poses), in private industry leaders are much less sanguine. We reiterated that discussion of QIZs with Turkey has always excluded the textile sector, and that even if Turkish QIZ's were to reemerge as a realistic possibility (something that does not now appear likely), this would remain the case. IKTIB members, however, stressed that without some such "privilege" from the United States, Turkey is likely to lose significant market share, resulting in severe economic hardship and a potential "social crisis."

¶9. (SBU) Turkish industry is painting a decidedly more gloomy picture than external observers, like the WTO, IMF and investment bankers, all of whom have predicted a more limited impact. It is also difficult to disentangle the impact of the end of quotas from exchange rate changes and more local factors (such as a 34 percent increase in the minimum wage earlier this year) that may be playing a part in the textile sector's loss of competitiveness. Nonetheless, the Turkish textile industry, which thrived behind the barriers of the quota system, is clearly in transition. The sector, while still large, is increasingly becoming less important to the Turkish economy: the share of textiles in total Turkish

exports of goods has fallen from 39% in 1998 to 29% currently, while total exports grew by 125% (nominally) since ¶1998. We suspect that the industry is overplaying the downside of the end of the Agreement on Textiles and Clothing to bolster their case for trade preferences. Embassy Ankara plans to report views of GOT officials and Ankara-based business organizations on these issues septel. End Comment.
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